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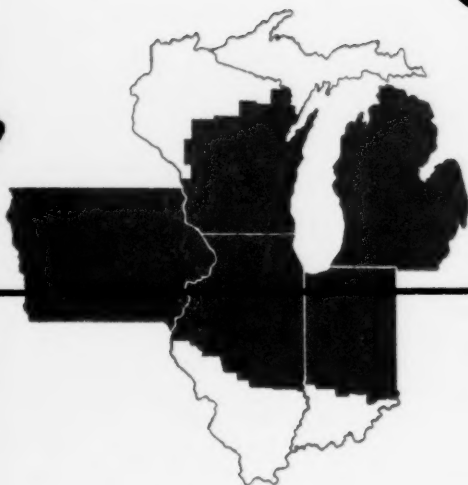
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A review by the **Federal Reserve Bank of Chicago**

Business Conditions

1952 January



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Defense backfires in Eastern Michigan

Automobile centers face rising unemployment as national security requirements take precedence over car production.

MIDWEST BUSINESS CONTINUES STRONG, but not in Detroit and Flint. Paradoxically, the defense program—supporting pillar for high business levels in the rest of the District—appears to be the main reason. Over the longer run this section may well reach new high levels of industrial activity; but currently it is in the throes of a serious adjustment.

Detroit and Flint are victims of a lag in defense production timing. These cities just do not have enough defense work now under way to offset the cutbacks in automobile production. Result—110,000 unemployed and several times that number on restricted work weeks. In addition, there have been numerous cases of layoffs from one or two days to a week or more in both automobile and supplier plants.

Short-run outlook bleak

Moreover, the outlook appears dark for some time to come. By mid-1952, unemployment is expected to reach about 140,000 in Detroit and 12,000 in Flint, if currently scheduled allocations of materials for civilian car production are carried out. This would mean about 10 per cent of the nonfarm labor force in these areas would be unemployed.

Few if any major, new defense plants in the area will be completed before late 1952. In most cases, construction could proceed faster, but equipment would not be available. Moreover, contracts frequently require long periods in the "make ready" stage even if no new construction is required.

The principal bottleneck is machine tools. Backlogs of orders for machine tools are so

large that many new plants will be unable to start production until well into 1953.

General business measures, such as retail sales and bank debits, are holding up better than employment and payrolls. These measures, however, are running behind those in other major industrial areas. For example, Detroit bank debits to individual accounts during the three months ended November 1951 were down 1.6 per cent in comparison with the same months of 1950. For the District as a whole, debits were up 5.6 per cent. During most post-war years, Detroit and Flint had been consistently above other District areas.

The current situation in Eastern Michigan is somewhat distorted, however, by comparison with the unusually high levels of last year. Total employment has indeed declined sharply during the last eight months, due almost entirely to lessened automobile output. Most major automobile companies are now employing 15 to 20 per cent fewer workers than at last year's peak. Even so, the December 1951 employment level was nearly 100,000 (8 per cent) higher than the average for 1949 and is about equal to the comparable month of 1949.

This is the more important when it is considered that 1949 was a year of relatively high automobile production. It was commonly stated that the housing and automobile industries were mainstays of business during that somewhat slack year.

Part of the current unemployment has resulted from an increase in the labor force. Over 100,000 additional job seekers have been added in the past two years. Some of these persons

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are young people who have reached working age and some are housewives brought into the labor market by family budget pressures. In addition, a substantial number are persons who have migrated to the area in response to expanded job opportunities. Most of these additional workers are relatively unskilled, and it is in the ranks of the unskilled that the unemployment problem is most troublesome. Tool and die makers, draftsmen, and engineers are in strong demand as defense contracts are programmed.

The problem

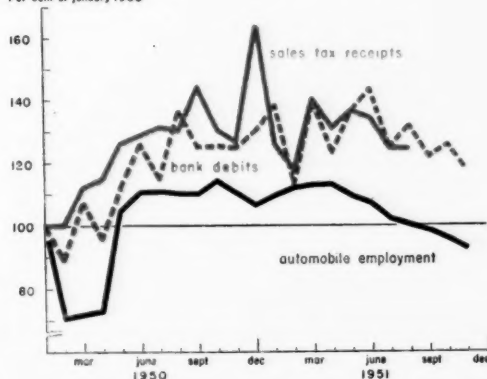
During World War II the bulk of the plant capacity in Eastern Michigan was used for output of war goods. In fact this area more than any other section of the nation came to be known as the "arsenal of democracy." In order to bring this about, however, it was necessary to suspend production of civilian cars. Many of the machine tools were put into storage and replaced by others. Conveyors were shifted and timed to conform to output of new products. "Conversion" and the later "reconversion" took place more dramatically in this area than in any other major region of the nation. As a result greater unemployment and other economic disruption occurred here than in most other areas.

Management and labor in the automobile industry as well as Government wished to avoid a repetition of this situation in the current mobilization effort. Although it was clear that only the automobile industry had the facilities and skills to undertake many of the defense contracts, it was equally clear that it would be impossible to produce automobiles and the large quantities of needed military equipment at the same time in the existing plants.

In the early stages of defense planning it was commonly believed that the partial defense program could and should be carried on with a minimum of restriction to the civilian economy. Also, increased total production capacity was emphasized as a major goal. Hence, the plans

Retail sales and bank debits have declined less . . . but are showing effects of employment drops

Per cent of January 1950



called for the erection of new plants or the reactivating of idle ones for defense production purposes. Existing plants were to be converted only partially to defense work, since there was no intention this time to stop civilian production.

About 20 major, new plants have been planned for location in the Detroit and Eastern Michigan industrial region. More than half of these are now in construction and nine are expected to be completed sometime in 1952. Probably no other industrial area of equal size has a greater volume of newly planned plants for defense use.

The more immediate defense production emphasis, however, was given to the reactivating of existing plant. And relatively little of this activity has taken place in the Detroit and Flint areas, although one large tank manufacturing operation is being readied for production in Flint, and activity in the Detroit tank arsenal has been stepped up sharply. Also, Kaiser-Frazer Corporation has replanned its huge Willow Run plant to accommodate both aircraft and automobile production. However, most large contracts involving reactivation of plants by automobile companies have been lo-

cated in Cleveland, Chicago, and elsewhere outside the Detroit-Flint area.

Some observers of the Detroit-Flint scene, and particularly representatives of the United Automobile Workers (UAW) have been critical of the manner in which defense production has been scheduled by the automobile companies and the Department of Defense. These critics agree that national security requires a reasonable dispersion of defense activities. In other words it would be unwise for Detroit to become as much of an arsenal as in World War II. However, security considerations allow plant location within reach of the Eastern Michigan labor force.

Among the criticisms most commonly voiced are that: (1) the Government delayed too long in taking the steps necessary to correct the machine tool shortage, and thereby slowed progress on defense contracts, (2) more existing facilities should have been replanned as dual-purpose plants, and less dependence placed upon new construction. It is also contended, principally in union circles, that even now greater defense production use could be made of present tools and floor space if there were sufficient urgency to get war production. However, no incentive is given to a company for converting a plant to parallel operations, whereas the accelerated amortization offers an important tax advantage for investment in new facilities.

Is defense fully responsible?

The automotive companies came close to reaching the goal of 1,100,000 passenger cars which the NPA allowed them to schedule in the fourth quarter of 1951. All of the big three companies (Chrysler, Ford, and General Motors) turned out their full quota, and strikes and material shortages accounted in part for the deficits of the independents below their quotas. Apparently, the NPA ceiling on car output did act as the limiting factor on production during recent months. The question remains, however, how many more cars would

have been produced under the prevailing price and demand conditions without controls.

In most localities throughout the country automobiles are readily available at the present time. Some dealers advertise: "No waiting—choice of models and colors." In large District centers new car buyers apparently are in the most favorable position since the start of World War II.

Used car inventories are ample. This apparently placid situation hides some disquieting notes, however. Car sales are at a seasonal low. New car inventories have been falling since June, and sales pressure to unload production could be intensified if a larger number of units were turned out. The car makers believe that additional output could be marketed if greater selling efforts were made.

The recent "plenty amidst scarcity" has sent some statisticians back to their slide rules in an attempt to re-evaluate the long-term demand for new cars. Studies made in recent years indicated a year-to-year output of something over four million cars when the postwar backlogs were finally cleared up. If these projections are valid the Detroit employment problem may be a long-range situation which might have developed about this time without any cutbacks in materials.

After six years of postwar effort the automotive industry has built up the private auto segment of our transportation facilities to a new peak, both in numbers and efficiency. Some quantitative evidence of this fact is provided by the Survey of Consumer Finances, conducted by the Board of Governors of the Federal Reserve System and published in the July 1951 issue of the *Federal Reserve Bulletin*. Early in 1951, 65 per cent of American families had cars—a rapid rise from 56 per cent early in 1949 and well above the 58 per cent for the end of 1941. In the case of urban families, 44 per cent owned cars three years old or less in early 1951 compared with 29 per cent in 1949 and 42 per cent in 1941. On the other hand, 40 per cent of all urban families had cars which

were more than seven years old, as against 18 per cent in 1941.

These ratios have grown more favorable from the standpoint of the adequacy of automobile transportation since the survey described above was taken. Over 5.3 million passenger cars rolled off the assembly lines in 1951 making a total of 17.3 million for the 1949-51 period. If four million cars are produced in 1952, that number will exceed any previous year with the exception of the last three and 1929.

Quotas dictate production schedules

Passenger car output declined 20 per cent between 1950 and 1951. The year-to-year drop, however, is not the full story. Production was high during the first half of 1951 and outran sales, but during the third quarter sales of new cars exceeded production. Sales may have exceeded output by a small margin in the fourth quarter also.

Under normal market conditions a drop in new car inventories would call for higher production schedules in the months immediately ahead. It is at this point, however, that NPA quotas are replacing car demand as the determinant of new car production.

Early announcements pointed to an output of

at most 4,400,000 passenger cars during 1952. These were to be scheduled at approximately 1,100,000 each quarter. The developing squeeze on essential materials, however, caused the NPA to reduce the quota to 930,000 units during the first quarter. Allotments of steel, copper, and aluminum under the Controlled Materials Plan (CMP) are based on this quota. Manufacturers have been told they can produce 1,006,000 during the first quarter if the additional output can be achieved by stretching allotments or digging into parts inventories. Preliminary indications suggest a ceiling of only 850,000 during the second quarter. Apparently, automobiles will be in short supply during the coming year.

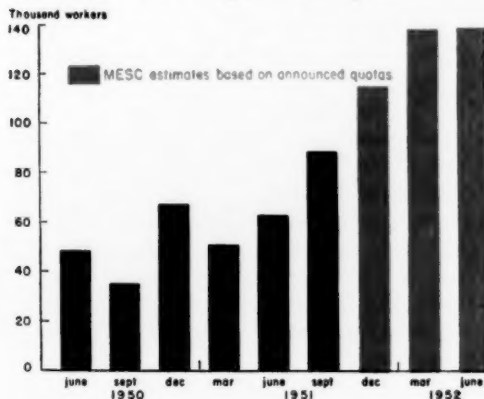
In more normal years local businessmen and consumers may judge for themselves the strength of the automobile market and make their plans accordingly. Estimates of manpower needs and probable retail sales levels now, however, are increasingly dependent on the latest announcements from Washington. Will automobile production be cut back still more? How important will new contracts awarded in the area be in counteracting the drop in civilian output? How fast will work proceed on those contracts already granted? These are the questions upon which Eastern Michigan businessmen and workers will be basing their expectations.

Labor market flexibility

The Detroit and Flint labor markets are more dependent upon manufacture of consumer durable goods for employment than any other major center in the nation. In Detroit, 53 per cent of all employed wage and salary workers are engaged in manufacturing, and a very high proportion of these are in the manufacture of durable goods. Also, Detroit has very little diversity in the types of durable goods produced. The automotive industry employs directly over 30 per cent of all wage and salary workers.

The Flint labor market shows even greater concentration in the one main industry. Slightly

Unemployment rising in Detroit . . . expected to be higher next year



over 60 per cent of all workers are employed in manufacturing. Of these, 92 per cent are in car manufacturing or directly related activity. The biggest factor making for stability of employment in this area during the postwar years has been the competitive strength of the products. Both Chevrolet and Buick have been leaders in their price class, and hence demand has remained strong throughout the last six years.

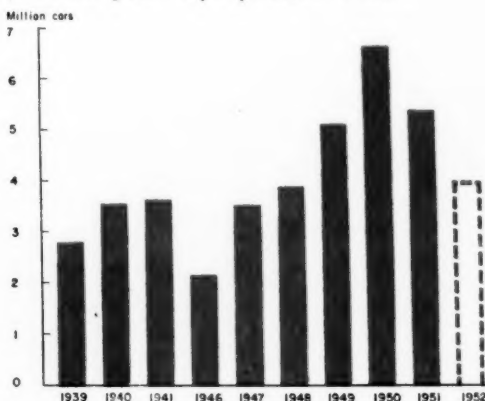
The Detroit and Flint areas are accustomed to frequent layoffs for short periods. In the postwar years, however, the level of automobile production has expanded steadily. Even during the minor recession of 1949, the output was high enough to give this region a level of prosperity above most sections in the Seventh District. Thus, despite the fact that wide variations in employment for brief periods of time are common to those labor markets, the general level of wage payments has been very high since World War II.

As a direct consequence of fluctuating demand for workers over many years, reserve pools of semi-skilled labor have developed in sections both adjacent to, and far removed from the Detroit and Flint areas. These reservoirs are in rural Michigan and in the states of Arkansas, Kentucky, Missouri, and Tennessee.

Their origin goes back to World War I, when the automobile companies carried on active recruiting of labor in certain counties of the southern states. The descendants, relatives, and friends of these earliest migrants travel to the Eastern Michigan area when labor demand is strong and return to their farms or homes when they are laid off. Local housing has adjusted to this situation by supplying a large number of small, furnished apartments which are available on weekly rentals.

It is this long-standing flexibility of the labor market which keeps the Detroit and Flint areas from having even more serious unemployment problems during downswings in employment. For example, manufacturing jobs in Flint declined by 11,100 from November 1950 to November 1951, but unemployment rose only

Auto output high in 1951 . . . quota for this year tops prewar level



3,200. A considerable part of this difference is accounted for by withdrawals from the labor force through the return of workers to their home communities.

Most of the labor force, however, consists of persons who have their permanent homes in the area. When layoffs affect persons having seniority back to 1942—as has been reported in some cases—the workers affected are not migrants and have virtually no employment opportunities outside the one dominant industry.

Some proposed remedies

Michigan ranks third in the nation in military prime contracts awarded. Only New York and California have received a larger volume. In fact, the proportion of total contracts awarded to automobile firms compares favorably with their World War II volume. Much of this work, however, is being done outside of the Detroit-Flint area. Moreover, as pointed out earlier very little defense work is actually being done currently in and around Detroit or Flint. Unskilled workers will not be required for the major contracts which are to be filled locally until new plants can be built and equipped.

In the meantime, a number of partial solu-

tions to the unemployment problem have been proposed. Some auto industry and union leaders are urging that production quotas for passenger cars should be raised. They believe that most of the required materials such as steel and aluminum are being set aside for the military faster than they can be used. Copper is indeed stringent, but it is contended that the present emergency constitutes a suitable time to draw down a certain, restricted tonnage from the Government stockpile.

It is also believed that additional defense contracts which would not require an extensive use of new machine tools could be performed in the Detroit area. For example, at the present time the facilities of most automobile parts makers are idle one to two days per week. It has been proposed also that procurement agencies could give special consideration to bids on new military contracts from Detroit firms.

The proposals described above would attack the unemployment problem by providing additional jobs. If no ready solution can be reached in this manner, union officials maintain that substantial additional Federal payments should be made to augment state unemployment compensation. It is argued that the hardships of the jobless worker are necessitated by the defense program, and it is unjust that a small portion of the working population should feel the full impact of production restrictions.

Dual-purpose plants suggested

A ray of hope has been cast upon the long-run problem of dealing with dislocations caused by partial mobilization and periodic world crises by Charles E. Wilson, president of General Motors. He suggests that new plants should be planned so that both military and civilian production would be possible at the same time, and so rapid changeovers could be made from one kind of output to another.

In an address delivered before the American Ordnance Association in Cincinnati, Mr. Wilson produced drawings showing how a dual-purpose plant might be laid out. He emphasized

that such general-purpose areas as offices, cafeterias, locker rooms, power plants, and tool rooms would be available for whatever kind of work was called for. Not all manufacturers having war contracts would require dual-purpose plants, but as Mr. Wilson points out, the larger companies—particularly those in the automobile industry—could use them most advantageously.

The long-run, stand-by nature of the defense program presents a strong argument for the parallel plant idea. It would provide maximum labor force utilization, and probably would entail a somewhat lesser outlay of capital plant and equipment than would be required with single-purpose plants.

So far, thinking along this line has been limited to new plants designed with the parallel purposes in mind. In fact, General Motors Corporation has begun construction of such a plant in Texas. Equally important, however, is the question of whether existing plants can be re-planned for efficient parallel use. If so, perhaps the basic purposes of national security would justify accelerated amortization for this purpose. This type of conversion would to some extent avoid the structural steel bottleneck which now exists and seems likely to persist through most of next year.

Emphasis on capacity

The most likely outcome seems to be that Detroit and Flint will limp along on restricted output until such time as the new plants are completed, probably late in 1952 or early 1953. Even then there is no certainty that defense activity will absorb all currently unemployed workers, especially in Detroit. It still is not known what level of production will be required from the defense plants in the area. The emphasis of the defense build-up is on capacity to produce rather than on production of large quantities of equipment subject to obsolescence. Nevertheless, many of the workers now unemployed will be needed for defense work when the new plants are ready.

THE Trend OF BUSINESS

CONTINUED HIGH LEVEL STABILITY characterized business conditions in the closing months of 1951, as most indicators of over-all activity showed only nominal changes. However, there is considerable evidence that upward pressures are developing. Prices and production were practically constant, although this partly concealed a balancing out of some divergent price and output trends. Sales have been less of a problem recently than earlier in the year. Christmas sales at department stores turned out to be approximately as high as those of the exceptional 1950 season. Even before the holiday buying had begun, retail inventories, especially in some previously over-stocked lines like television sets, had been worked down substantially.

Portents of incipient upward pressures can be found in recent trends in various types of credit extensions. With certain exceptions, extensions that had been declining have leveled off, and those that had leveled off earlier in the

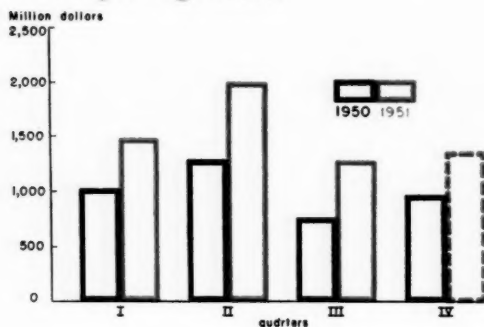
year have begun to rise again. In addition, personal income rose during the fall and liquid asset holdings continued to grow.

The continued high or rising levels of most types of borrowing as well as these other indicators of financial strength can provide the financial basis for sharp increases in demand. In fact, the money supply on October 31 reached an all-time peak. Combined with the evidence of some increase in consumer demand during the holiday season, credit developments suggest that the achievement of defense goals without inflation will be a problem in 1952.

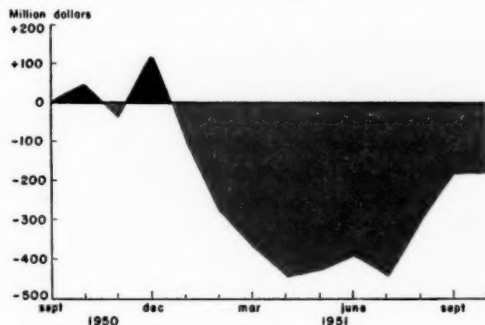
Business loans of weekly reporting member banks, both in the District and the nation, continued to rise more than could be explained by seasonal influences, largely due to borrowing for defense production. However, the rise is still below the large jump during the comparable period in 1950, as discussed more fully in an article in this issue beginning on page 10.

New corporate security issues raising

New corporate security issues raising new capital substantially above year-ago levels



Consumer instalment credit rising since relaxation of Regulation W*



*Cumulative changes since September 1950

new capital have increased over last year even more dramatically. For the first nine months of the year, the 1951 total was more than 50 per cent greater than for the corresponding period of 1950. The announcement at the end of November of the spectacular prospective borrowings by Union Carbide and Westinghouse Electric indicates that this source of funds will continue to be heavily tapped in the near future. The two issues, composed of long-term obligations to be placed with institutional investors, will total 550 million dollars.

Agricultural loans of commercial banks, as indicated by call report information, rose rapidly during the third quarter of the year, as reported in an article in the December issue of *Business Conditions*. There is evidence that this rapid rise has continued since October.

Consumer instalment credit has picked up substantially since the relaxation of Regulation W at the end of July, but the latest data available show much less change than occurred during August and September. The total outstanding is still below the very high levels reached in the summer of 1950 prior to the imposition of Regulation W.

State and local governments continue to accumulate funds for construction through high bond sales, despite current and prospective

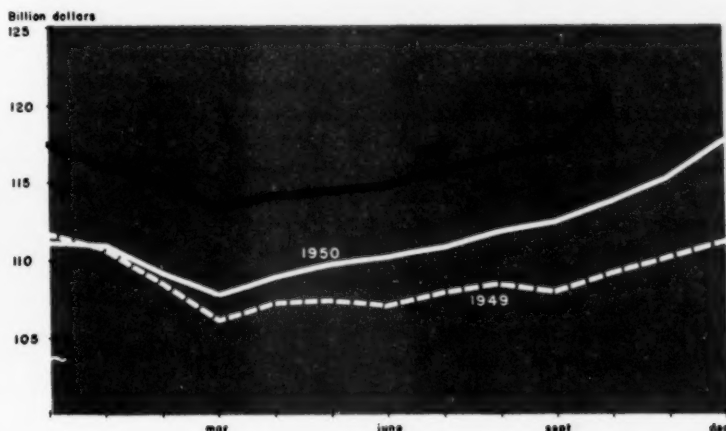
difficulties in securing materials for many projects for which bonds are being sold. Large flotations of Federally guaranteed local housing authority bonds in July and October were a major factor in keeping the 1951 sales close to the record levels of a year earlier.

Mortgage loans held by commercial banks, mutual savings banks, savings and loan associations, and life insurance companies continue to grow, but the rate of growth is becoming progressively smaller. Since mortgage extensions are closely connected with the number of housing starts, this source of credit to consumers can be expected to be an exception to the general trends in credit. Illinois and Wisconsin appear to have been less affected by the decline in recordings of nonfarm mortgages of 20,000 dollars or less from comparable months a year ago, than the rest of the Midwest and the nation generally.

The Federal Government will be another exception in the months immediately ahead. Although Treasury cash deficits of 1.3 billion dollars in the third quarter and about 4 billion in the fourth quarter resulted in extensive cash borrowing, heavy tax collections during the first half of 1952 should produce a substantial surplus and significant net repayment of borrowing, at least through March.

Active money supply reaches all-time peak

The continued expansion of bank loans, combined with Treasury operations on a deficit basis, pushed the privately-held money supply to over 120 billion dollars at the end of October, three billion dollars above the previous peak reached in December 1950, and nearly 10 per cent above the level at the outbreak of the Korean War.



Business loans since midyear

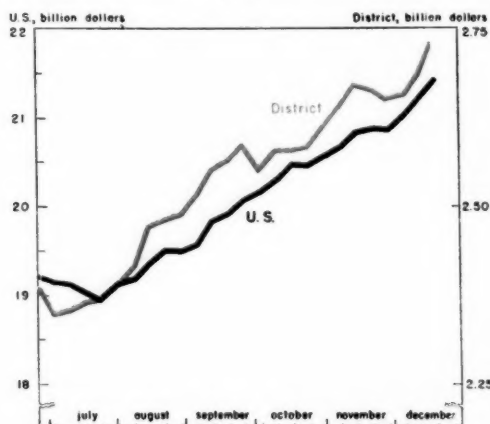
Loans made to businesses have risen substantially since June 1951—and slightly more in the Seventh District than in the nation. Defense needs, seasonal demands, and anti-inflationary measures have shaped the over-all pattern.

COMMERCIAL, INDUSTRIAL, AND AGRICULTURAL LOANS at weekly reporting member banks rose 2 billion dollars between the first of June and the middle of December in the year just past.

This fact is simple to state; but to ferret out its meaning is no easy job in view of the complex and conflicting movements in business during 1951. Was the loan increase "too big," "too small," or "just right"? Financial observers have disagreed, some expressing concern over so large an addition to private spendable funds, others feeling that the expansion represented no more than the minimum necessary to enable business to meet its essential seasonal and defense commitments.

The correct answer can be important. The very fact that this loan series receives so much attention is evidence of the significance of business loan movements to the course of business activity. Like any other form of bank loan expansion, business loan increases add directly to the nation's spending power, and hence to expansionary pressures. Unlike many other types of credit, however, business loan changes also carry implications of changes in the economy's flow of goods and services. Borrowings to finance expansion and improvement of facilities are harbingers of greater output in the months ahead. Absorption of more or higher cost goods into the inventory pipelines of business, whether for civilian or defense uses, generally is reflected in increased use of bank credit. On the other hand, net repayments of business credit appear quickly when businessmen foresee a slackening in market demands and begin to act accordingly. Since larger firms borrow-

Business loans at reporting banks climbed unevenly after mid-1951



ing in the major financial centers are among the first to engage in these kinds of actions, total business loans at reporting member banks have consistently been one of the leading indicators of ups and downs in general activity.

It is not surprising, therefore, that this series has come to be one of the most carefully watched measures of the changing business and financial scene. With the economy now delicately balanced between continuing price stability and reappearing inflation, recent business loan movements deserve a careful appraisal.

The distribution of new business credit

What happened to the 2 billion dollars of new business credit extended by reporting

banks since last June? The chart on this page gives as much of the answer as is available—namely, the distribution of increases in larger commercial loans made by the nation's largest banks from June through November.

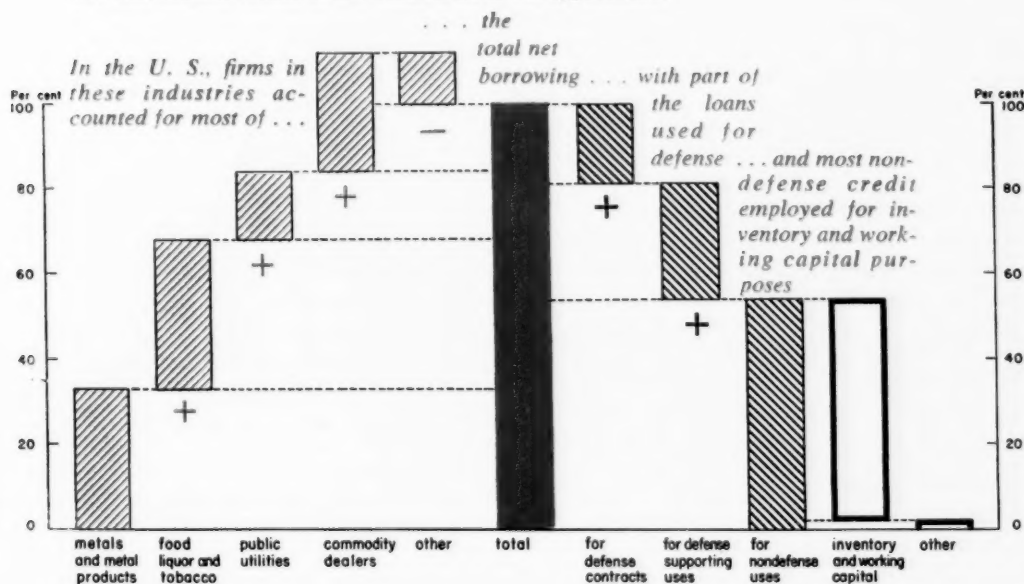
Nearly half of the total dollar volume of this credit went into defense and defense-allied uses. Upwards of 400 million went directly to facilitate production under defense contracts, primarily granted to producers of metals and metal products. These firms, which are not ordinarily seasonally heavy borrowers in the fall, absorbed fully one-third of the total increase in business credit at larger banks. Another unusually heavy borrower during the last half of 1951 was the public utility industry.

Growing demands for power, water, and transportation and communication services were a natural by-product of the side-by-side expansion in national defense projects and essential civilian needs. Loans to utilities are ordinarily considered as "defense-supporting," in the sense that such credit finances the maintenance or expansion of output of essential materials or basic public services.

As might be expected, the dominant role in the loan growth was played by firms which habitually experience heavy increases in needs for outside funds during the fall. Primarily, these are concerns engaged in the processing and distribution of agricultural commodities, which tie up large sums of money in inventory

Where the money went and how it was used . . .

In 1951, the over-all June-November rise in business loans was more than accounted for by increases in larger loans made by large banks in the nation's major cities. Such loans climbed 300 million dollars in the Seventh District during the period, and 2.0 billion dollars for the nation as a whole. This is how that national volume of new business credit was apportioned:



and working capital as the fruits of the nation's harvest move to market. To finance market operations, commodity dealers borrowed more than one-half billion dollars from large banks from June through November. This total was appreciably less than year-ago requirements, in part because of some early fall storage of crops under loan agreements guaranteed by the Commodity Credit Corporation and serviced by country banks. In 1950, the rapid rise in farm prices had encouraged almost complete dependence upon private sources for financing distribution of current crops and accumulated stocks.

Food, liquor, and tobacco processors, on the other hand, demanded considerably more credit during the fall of 1951 than in the comparable months of 1950. Partly because of higher prices and a larger volume of supplies, such firms borrowed more than any other group of borrowers during recent months.

Credit cutbacks in some areas

Of equal significance, however, are those industries which were *not* granted a sizable volume of new credit during the last six months of 1951. In the borrowing activity in these areas could be seen most clearly the effects of three prevalent anti-inflationary pressures: (1) the extended letdown in some segments of consumer demand; (2) the general and selective credit controls imposed by the Federal Reserve System; and (3) the Voluntary Credit Restraint Program being followed by most lenders.

With Regulation W helping to deter consumer credit expansion, sales finance companies made net repayments of credit during the fall of 1951. In the corresponding months of 1950 these firms had accounted for well over 10 per cent of the business loan extensions at larger banks. Even more marked was the shift in loan position of the textile, apparel, and leather industry. After borrowing substantially in the early post-Korean period, the industry repaid over 300 million dollars in net

business credit during the last half of 1951. Relatively weak sales, an unencouraging price structure, and some consequent attempts to reduce inventory positions were important reasons behind the change.

Construction firms, moderate borrowers during the fall of 1950, also repaid business loans on balance during the comparable months of 1951. Tighter mortgage terms under Regulation X, and the unattractiveness of fixed Government-insured mortgage rates relative to the higher general interest pattern, had served to narrow significantly the effective market for new housing.

Bank loans to the retail and wholesale trade are not particularly centered in larger banks. Nonetheless, trade borrowings amounted to more than one-tenth of the business loan expansion in such banks during the last half of 1950. In the last half of 1951, however, the volume of business credit extended to trade firms was cut to a fraction of the 1950 total.

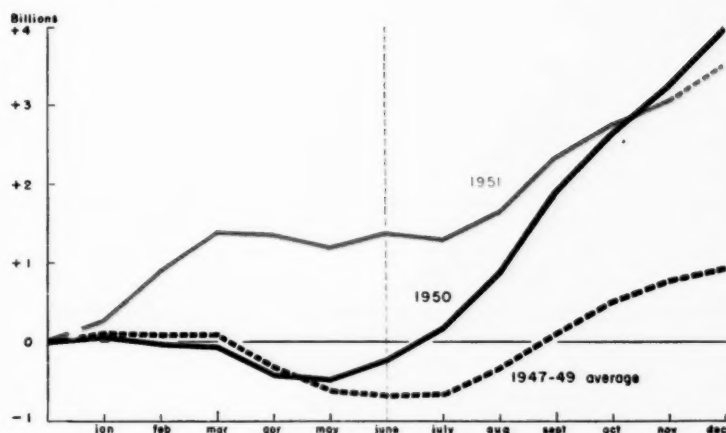
For almost all types of concerns, one major

Social security covers self-employed

Since the beginning of 1951, most self-employed individuals and partners have been covered by the Old-Age and Survivors Insurance provisions of the Social Security Act. The first \$3,600 of annual net earnings of those covered are subject to the social security tax, presently at the rate of 2¼ per cent. The first returns under this extension of the program, reporting net earnings for 1951, must be filed by March 15 or within two months and fifteen days of the close of the firm's fiscal year. Information with respect to coverage, reporting, and tax rates is available from any of the several Social Security field offices in the District.

Annual increases in business loans

During 1951, the net additions to the beginning-of-year total of business loans added up to nearly \$3½ billion. This was smaller than the record 1950 gain, but much larger than the average for previous years. Major reason: the big contra-seasonal rise last spring. Since June 1951, the increase has been only moderately greater, on a dollar basis, than the average 1947-49 last-half expansion.



use of credit bulked less large in 1951 than in 1950. In the earlier year, anticipations of sharp inflation and shortages had induced a general effort to accumulate inventories. Bank loans served as an important source of funds for such investment. After the spring of 1951, however, unseasonally large additions to stocks of civilian goods became the exception rather than the rule. Expectations of strong markets and price increases dwindled, and lender cooperation under the Voluntary Credit Restraint Program grew. As a result, firms became both less willing and less able to borrow bank funds for purposes of inventory accumulation.

Business loans rise more in District

A hasty glance at statistical totals can lead to the conclusion that banks in the Seventh District have been less restrained than their counterparts in other areas in the recent expansion of business credit. The growth in business loans in reporting District banks matched or exceeded the national average during much of the post-Korean period. Since June 1951, District business loans have risen 13 per cent, one-third more than the national growth of 10 per cent. Moreover, recent increases in credit for nondefense industries have

been larger in the District than the average for the remainder of the nation.

In this case, however, over-all figures do not tell the true story. In great measure, the District record is an outgrowth of the particular industrial "mix" of customers borrowing from the Midwest's larger banks. For example, the heaviest nondefense borrower over the nation during the fall of 1951 was the food, liquor, and tobacco industry. District banks normally extend a disproportionately large share of the credit used by this industry. The latter is also true for the petroleum industry, which sharply increased borrowings over year-ago levels to finance expansion programs.

On the other hand, some of the industries, the borrowings of which were most sharply cut back in 1951 as compared with 1950, are not particularly important in the District credit picture. Commodity dealers and the textile, apparel, and leather industry are cases in point. As a result, parallel District reductions in credit extended to these borrowers did not proportionately reduce the net figure for District business loan expansion. In the main, it was such geographical differences in the composition of business rather than relative liberality or conservatism in bank lending that accounted

Department store data revised

Indexes of Department Store Sales and Stocks, published by the Federal Reserve System, have been revised for the period 1919 to date. This revision includes, among other things, a shift in the base period from 1935-39 to 1947-49. This new base period is one generally accepted for use in current revisions of statistical series. Copies of the revised indexes for the Seventh District and its larger cities as well as a description of the procedure followed in calculating them are available upon request to the Research Department of the Federal Reserve Bank of Chicago.

for District deviations from the national pattern of business loan expansion this fall.

Was the rise too big?

The increase of 2 billion dollars in business loans at reporting banks in the last half of 1951 was large even by postwar standards. It was certainly greater in dollar volume than the historical "seasonal" growth, which since World War II has averaged something less than 1.5 billion in the last six months of each year. But during late 1951 several factors were in operation which made a somewhat larger dollar volume of business loan expansion inevitable.

Seasonal needs for banking funds were somewhat higher in 1951 because of the accumulating effects of price increases on raw materials and supplies. Cash drains resulting from higher corporate tax levies and developing expansion programs also added to the need for outside funds. In addition, business credit demands under the defense program were growing. Credit advanced on defense contracts during the last half of the year amounted to 400 million dollars, enough to account for most of the dollar excess of the 1951 growth over the normal "seasonal."

On the other hand, some firms which borrowed on defense contracts would otherwise have engaged in seasonal borrowing to finance civilian production. Their abstinence from such borrowing in 1951 served to reduce the volume of needed nondefense borrowing of a purely seasonal nature. Moreover, the great increase in business loans during late 1950 and early 1951, and the volume of repayments flowing therefrom by late 1951, would have tended to reduce the *net* bank loan expansion needed to accommodate ordinary demands.

These conflicting influences on the magnitude of business credit needs during the last half of 1951 are, by their very nature, impossible to measure quantitatively. A concluding appraisal of the magnitude of the fall expansion in business loans must be phrased in qualitative terms.

All facts considered, the increase seemed sufficiently large and well-distributed to indicate that the minimum credit needs of business during that period were generally satisfied. At the same time, the rise was not inordinately large. It was half the comparable 1950 increase and reflected substantial cutbacks in credit use by important types of business.

These facts, however, do not justify a complacent attitude toward the possible inflationary ramifications of business loan increases. The past experience commends an even more careful application of conservative and anti-inflationary standards to credit extensions, whenever and wherever possible.

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Savings bonds *continued from page 16*

up to a maximum of 50 per cent of the par value; should the price level decline, the bonds will be redeemed at par.

Other current suggestions are more in the nature of features—not necessarily mutually exclusive—which could be substituted without changing the essential form of the present bond or causing widespread redemptions for purpose of exchange. One such proposal is to make interest from savings bonds fully or partially tax exempt. Such a provision would probably necessitate more restrictive limitation on the amount of individual holdings of E bonds or possibly a limitation on the tax exemption privilege itself. Since the prospect for a smaller individual tax load is slight, probably any form of tax exemption on bonds would increase their appeal.

The yield question

Another of these remedial suggestions is to improve the redemption schedule on E bonds so as to yield a higher return during the earlier years of the bond's life. The present annual yield on E bonds held to maturity compares quite favorably with the return paid by alternative savings media—2.9 per cent as against an average of 2.1 per cent for mutual savings bank deposits, somewhat over 2.5 per cent for savings and loan shares, or a range up to 2½ per cent for commercial bank time deposits. But for short-term investment, these other media fare much better rate-wise, since under the present redemption terms, an E bond held one year, for example, earns only 0.67 per cent, or if it is redeemed after three years, its annual yield is only 1.31 per cent. Although it is frequently contended that E bond holders are not "rate-conscious," proponents of this move argue that widely advertised increases in rates offered by these competing types of savings institutions have made the saver much more interested in the amount of return his funds will earn. "Flat-tening" the redemption schedule would tend to make E bonds more attractive to those invest-

ors—i.e., smaller savers—who are uncertain that they can hold their funds for a full ten years and do not want to risk receiving only relatively small rates of return should they need their funds in say three or four years.

Topping the list of suggested improvements in the present bond, however, is the simple proposal that the over-all yield on E bonds be raised to conform more closely with the general rise which has occurred in the interest rate pattern. Both England and Canada have raised the rates on their comparable savings securities. In England, where the change from a 2.5 per cent to a 3.0 per cent savings certificate was made early in 1951, net sales increased markedly, although there too the postwar years had seen a steadily declining volume of these issues outstanding. In this country, existing law places a ceiling of 3 per cent on the savings bond rate. Presumably, those who favor a rate increase would want the law changed to permit a higher yield—possibly around 3.5 per cent.

Unquestionably, an increase in the rate paid on savings bonds and the addition of a tax-exemption privilege would bring forth a positive response from larger investors. It is quite possible that such response would be great enough to turn the savings bond program from a declining to an expanding one. The question arises, however, as to the merits of reinvigorating the program by relying upon the heavy support of large investors. Is this approach not at odds with the original purpose of the program—i.e., to distribute the debt among the vast number of small savers who would not otherwise be buying government securities of any kind? Is it not in this relatively lower income segment of the population where the program would function most effectively as a contra-cyclical financial device? Because of the widespread disagreement or confusion on these issues, an accurate reappraisal of the true nature of the savings bond program and the function it is to serve in our economy is a necessary first step in any attempt to prop up the present program.

Savings bonds

Recent drive focuses further attention upon the problem of increasing bond appeal.

THE TREASURY'S RECENT SAVINGS BOND CAMPAIGN has come and gone, leaving in its wake little cheer and much speculation as to the future of the savings bond program. Although net redemptions of Series E bonds declined moderately during the months of September and October, the impact of the Drive upon bond sales was not vigorous enough to swing the E bond trend into the black.

Payroll plans promising

One rather promising development, which current figures do not as yet reveal, was provided by the Payroll Savings Plan—the major target of the sales campaign. Bond sales through these plans have shown an improvement over previous year levels, contrary to sales by other methods. Spurred on by the Drive, a sizable number of additional firms instituted or reinstated payroll savings plans and many additional individuals subscribed to plans already in force. In Illinois, for example, 36 companies joined the payroll savings program, the largest of which was the Chicago and Northwestern Railroad with over 25,000 employees.

Nevertheless, the headway made in this one part of the over-all E bond program falls far short of offsetting the heavy rate of E bond redemptions. Thus the Drive has served to call further attention to the public's general apathy to savings bonds as a savings medium and to stimulate renewed interest in the problem of increasing their appeal. Although no official action has been scheduled, three or four proposals are currently the subject of considerable attention.

The most "radical" of these recommendations is the issuance of a "purchasing power"

bond which would be redeemable in a fixed amount of purchasing power rather than a fixed amount of dollars. Such a proposal is intended to meet the most vocal criticism of the present bond—i.e., loss in real value resulting from a mounting price level. This problem of offsetting the impact of inflation upon all types of fixed income investments has been the object of much concern both here and abroad. One step in this direction was recently taken by the Teachers Insurance and Annuity Association of America which services some 70,000 college teachers and pensioners. Beginning early this year, approximately half of this organization's income from annuity premiums will be put into equity investments through its newly formed College Retirement Equities Fund. Some more pertinent indication of the workability of a purchasing power bond may be gained from the experience with a new 20-year, 3 per cent bond now being issued in Sweden. Offered by the Swedish Cooperative Association, the bond is nonmarketable, redeemable at par after 1955 on six months' notice, or redeemable at maturity at par plus a premium. The premium will be directly proportionate to the rise in prices,

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Redemptions of E bonds exceeded sales each month in 1951, but in November maturities accounted for the gap

